No. 15858

In the United States Court of Appeals for the Ninth Circuit

ARTHUR EARL MCKNIGHT, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION

BRIEF FOR THE APPELLEE

GEORGE COCHRAN DOUB,
Assistant Attorney General,
LAUGHLIN E. WATERS,
United States Attorney,
MORTON HOLLANDER,
ROBERT S. GREEN,
Attorneys,
Department of Justice, Washington 25, D. C.

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STATEMENT

This action was brought by the United States to recover moneys paid out by it under its guaranty as a result of default by defendant McKnight on a G. I. home loan. McKnight had been the recipient of a loan guaranteed by the Government, pursuant to the Servicemen's Readjustment Act of 1944, as amended (*infra*). The district court held the Government entitled to recovery and entered judgment in its favor and against McKnight for $1,453.64, plus interest. The district court's jurisdiction was based on 28 U. S. C. 1345, and this Court's jurisdiction rests on 28 U. S. C. 1291. The relevant facts as found by the court below,[1] may be summarized as follows (R. 9–14):

[1] The present appeal is before this Court on an Agreed Statement (R. 3–8) pursuant to Rule 76, Federal Rules of Civil Procedure. The district court's findings have been accepted by both parties as the facts for this Court's consideration on appeal (R. 8).

On August 1, 1947, McKnight, a veteran of World War II, eligible for benefits under the Servicemen's Readjustment Act of 1944, obtained a home loan from the Porterville Mutual Building and Loan Association of Porterville, California, in the sum of $6,750.00. In return he executed his promissory note in the Association's favor, whereby he promised to pay the principal sum plus interest at 4 percent per annum in installments. McKnight's obligation was secured by a deed of trust on the real property in question and was incurred for the purpose of his purchasing that property. On the same date the note was executed, McKnight signed Veterans Administration Form 4–1820 "Home Loan Report" and thereby applied to the Veterans Administrator for a guarantee of 50 percent of the loan under the provisions of the Servicemen's Readjustment Act of 1944, as amended. The Veterans Administrator approved the Home Loan Report and the application contained therein and on October 30, 1947, issued V. A. Form 4–1899, "Loan Guaranty Certificate," guaranteeing payment of 50 percent of the $6,750.00 loan, or $3,375.00.

On September 1, 1947, McKnight defaulted on payment of the note and loan to the Porterville Mutual Building and Loan Association, and remained in default at all times thereafter. The Association elected to declare the whole sum of the principal and interest due immediately. On November 26, 1947, it notified the Veterans Administrator by letter of McKnight's default and of its own election to foreclose on the loan and security. On December 4, 1947 the Veterans Administrator notified McKnight by registered mail that

any sums paid out by the Government in satisfaction of a claim under the guarantee on the loan would constitute a debt owing by McKnight to the United States Government.

Thereafter, on January 23, 1948, the Association filed a claim with the Veterans Administrator for payment of the loan guarantee—$3,375.00. The Veterans Administrator subsequently paid this amount to the Association.

In the interim, on January 26, 1948, the Association published and recorded in the official records of Tulare County, California, its Notice of Default and Election to Sell the real property which secured, under Trust Deed, the McKnight loan. The Veterans Administrator authorized an appraisal for foreclosure purposes.[2] On April 16, 1948, an appraisal was made and reported on Veterans Administration Form 4–1803. The liquidation value of the subject property on that date was set at $6,171.00.

Thereafter, on May 1, 1948, the Veterans Administration, in accordance with the applicable law and regulations, established the "upset price" to govern the trustee's sale of the property. This "upset

[2] With reference to such appraisal the Veterans Administrator instructed the appraiser specifically as follows:

"Care should be exercised by the appraiser upon acceptance of the assignment to estimate a price which will produce a sale under present market conditions and at the same time protect the interests of the administration. Special attention should be given to items of repair to insure safeguarding the property as well as increasing saleability. The appraiser should alter his certificate to clearly show that the appraisal is made for liquidation purposes and is not to be construed as 'reasonable value.'"

price'' was $5,500.00. The Administrator then authorized the sale of the real property subject to the trust deed and subject to the said upset price of $5,500, all in accordance with the applicable law and regulations. On May 27, 1948, at the trustee's sale, property was sold to the Porterville Mutual Building and Loan Association for the sum of $5,500.00.

As of May 27, 1948 immediately prior to the trustee's sale, the balance due the Association from McKnight, after crediting to the account the $3,375.00 paid by the Veterans Administrator, was the net sum of $3,578.64. As of the same date, immediately after the trustee's sale, the sale price of $5,500, was further credited to McKnight's account, thereby extinguishing McKnight's indebtedness to the Association and leaving an excess in the hands of the Association of $1,921.36. The latter sum under the applicable law and regulations was to be held for the use and benefit of the Government. It was later credited by the Veterans Administrator against the sum of $3,375.00 previously paid out by him.

The Veterans Administrator, the trial court found, thus suffered a loss in the payment of the claim upon the guarantee on McKnight's loan of $3,375.00, which loss was reduced to $1,453.64 after application of the $1,921.36 credit. McKnight, the court stated, had refused to pay any part of the balance due the Government.

McKnight had contended in the court below, citing 38 U. S. C. 694 (g), *infra,* pp. 7–8, that the Government, in its efforts to recover on the guarantee was limited to whatever rights the Association had. He further

argued that the present action was one for a deficiency judgment and that since Section 580 (b) of the California Code of Civil Procedure bars deficiency judgments, the Association, and, therefore, the Government as well, would be precluded from recovery.

The district court however, reached the following legal conclusions (R. 14–16): The court had jurisdiction of the Government's claim under 28 U. S. C. 1345. This claim, in turn rested on lawful regulations issued pursuant to the Servicemen's Readjustment Act of 1944 as amended. These regulations (*infra,* pp. 9–10), which were in force at all material times, made McKnight liable to indemnify the Veterans Administrator for any loss resulting from the guarantee of McKnight's liability under the provisions of the 1944 Act. This loss the court fixed at $1,453.64,[3] and judgment for that sum plus interest and costs, amounting to $2,027.57, was entered for the Government.

Statutes and Regulations Involved

The Servicemen's Readjustment Act of 1944, as amended, 38 U. S. C. 693 *et seq.,* provides in pertinent part as follows:

> Sec. 500 (a), 38 U. S. C. 694 (a). General provisions governing loans—(a) Eligibility; amount of guaranty; computation.

[3] The district court rejected as irrelevant defendant's offer to prove that the Administrator subsequently acquired the property in question from the Portersville Mutual Building and Loan Association in accordance with VA regulations at a total cost of $7,047.50 and resold it for a gross price $6,850—the net proceeds to the Administrator being $6,631.88.

Any person who shall have served in the active military or naval service of the United States at any time on or after September 16, 1940, and prior to the termination of the present war, or at any time on or after June 27, 1950, and prior to such date as shall be determined by Presidential proclamation or concurrent resolution of the Congress, and who shall have been discharged or released therefrom under conditions other than dishonorable after active service of ninety days or more, or by reason of an injury or disability incurred in service in line of duty, shall be eligible for the benefits of this subchapter. Entitlement derived from service on or after June 27, 1950, shall (1) cancel any unused entitlement derived from service prior to June 27, 1950, and (2) be reduced by the amount entitlement from such prior service shall have been used to obtain a direct, guaranteed, or insured loan (a) on real property which the veteran owns at the time of application or (b) as to which the Administrator shall have incurred actual liability or loss, unless in the event of loss or the incurrence and payment of such liability by the Administrator, the resultant indebtedness of the veteran to the Government shall have been paid in full. * * *

SEC. 501 (a) (2), 38 U. S. C. 694a (a) (2). Loans for homes; amount of guarantee.

(a) Any loan made to a veteran under this subchapter, the proceeds of which are to be used for purchasing residential property or constructing a dwelling to be occupied as his home or for the purpose of making repairs, alterations, or improvements in property owned by him and occupied as his home, is automatically

guaranteed if made pursuant to the provisions of this subchapter, including the following

* * * * *

(2) That the contemplated terms of payment required in any mortgage to be given in part payment of the purchase price or the construction cost bear a proper relation to the veteran's present and anticipated income and expenses, and the veteran is a satisfactory credit risk; and that the nature and condition of the property is such as to be suitable for dwelling purposes * * *.

SEC. 504 (a), 38 U. S. C. 694d (a). Rules and regulations; delegation of authority; minimum construction requirements; appraisals.

(a) The Administrator is authorized to promulgate such rules and regulations not inconsistent with this subchapter, as are necessary and appropriate for carrying out the provisions of this subchapter, and may delegate to subordinate employees authority to issue certificates, or other evidence, of guaranty of loans guaranteed under the provisions of this subchapter, and to exercise other administrative functions under this subchapter.

SEC. 506, 38 U. S. C. 694g. Procedure on default; release from liability.

(a) In the event of default in the payment of any loan guaranteed under this subchapter, the holder of the obligation shall notify the Administrator who shall thereupon pay to such holder the guaranty not in excess of the pro rata portion of the amount originally guaranteed, and shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid on the guaranty: *Provided,* That prior to suit or foreclosure the holder of the

obligation shall notify the Administrator of the default, and within thirty days thereafter the Administrator may, at his option, pay the holder of the obligation the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security: *Provided further,* That (1) nothing in this section shall be construed to preclude any forbearance for the benefit of the veteran as may be agreed upon by the parties to the loan and approved by the Administrator; and (2) the Administrator may establish the date, not later than the date of judgment and decree of foreclosure or sale, upon which accrual of interest or charges shall cease.

(b) Whenever any veteran disposes of residential property securing a guaranteed, insured, or direct loan obtained by him under this subchapter, the Administrator, upon application made by such veteran and by the transferee incident to such disposal, shall issue to such veteran in connection with such disposal a release relieving him of all further liability to the Administrator on account of such loan (including liability for any loss resulting from any default of the transferee or any subsequent purchaser of such property) if the Administrator has determined, after such investigation as he may deem appropriate, that (1) the loan is current, and (2) the purchaser of such property from such veteran (a) has obligated himself by contract to purchase such property and to assume full liability for the repayment of the balance of the loan remaining unpaid, and has assumed by contract all of the obligations of the veteran under the terms of the instruments creating and securing the loan, and (b) qualifies from a credit standpoint, to the same extent as if he were a

veteran eligible under section 501 (a), for a guaranteed or insured or direct loan in an amount equal to the unpaid balance of the obligation for which he has assumed liability.

Veterans Administration Regulation 36.4323, 38 C. F. R. (1949 ed.) 36.4323, provides as follows:

Subrogation and indemnity.—(a) The Administrator shall be subrogated to the contract and the lien or other rights of the holder to the extent of any sum paid on a guaranty or on account of an insured loss, which right shall be junior to the holder's rights as against the debtor or the encumbered property until the holder shall have received the full amount payable under his contract with the debtor. No partial or complete release by a creditor shall impair the rights of the Administrator with respect to the debtor's obligation.

(b) The holder, upon request, shall execute, acknowledge and deliver an appropriate instrument tendered him for that purpose, evidencing any payment received from the Administrator and the Administrator's resulting right of subrogation.

(c) The Administrator shall cause the instrument required by paragraph (b) of this section to be filed for record in the office of the recorder of deeds, or other appropriate office of the proper county, town or State, in accordance with the applicable State law. The filing or failure to file such instrument for record shall have the legal results prescribed by the applicable law of the State where the real or personal property is situated, with re-

spect to filing or failure to so file mortgages and other lien instruments and assignments thereof.

The references herein to "filing for record" include "registration" or any similar transaction, by whatever name designated when title to the encumbered property has been "registered" pursuant to a Torrens or other similar title registration system provided by law.

(d) As a condition to paying a claim for an insured loss the Administrator may require that the loan, including any security or judgment held therefor, be assigned to the extent of such payment, and if any claim has been filed in bankruptcy, insolvency, probate, or similar proceedings such claim may likewise be required to be so assigned.

(e) Any amounts paid by the Administrator on account of the liabilities of any veteran guaranteed or insured under the provisions of the act shall constitute a debt owing to the United States by such veteran.

ARGUMENT

I. The United States is entitled to indemnity from the defendant for the loss which it suffered as a guarantor of his loan

A. Defendant is bound by a valid regulation to indemnify the United States for its loss

In establishing the Veterans Administration's program of home loan guarantees for veterans, the Servicemen's Readjustment Act of 1944, 38 U. S. C. 693, *et seq.*, expressly authorizes the Administrator of Veterans Affairs to promulgate such rules and regulations as are necessary and appropriate to carry out

the provisons of the Act. 38 U. S. C. 694d. Pursuant to this statutory authority, the Administrator has provided by regulation that "[a]ny amounts paid by the Administrator on account of the liabilities of any veteran guaranteed or insured under the provisions of the act shall constitute a debt owing to the United States by such veteran." 38 C. F. R. (1949 ed.) 36.4323 (e). This regulation was published in the Federal Register on March 1, 1946 (11 F. R. 2123); it was incorporated by reference into defendant's application for a loan guarantee, and unless inconsistent with the statute, was binding upon him. *Federal Crop Ins. Co.* v. *Merrill,* 332 U. S. 380; *United States* v. *Zazove,* 334 U. S. 602.

1. *The regulation requiring indemnity is valid.* It is, of course, well settled that a regulation promulgated by an agency charged with the duty of administering a statutory program is entitled to great weight, and can be overturned only if it is clearly inconsistent with the statutory intent. *Norwegian Nitrogen Co.* v. *United States,* 288 U. S. 294, 315; *United States* v. *American Trucking Associations,* 310 U. S. 534, 549; *Great Northern Ry. Co.* v. *United States,* 315 U. S. 262, 275; *United States* v. *Citizens Loan & Trust Co.,* 316 U. S. 209; *Colgate Co.* v. *United States,* 320 U. S. 422, 426; *Billings* v. *Truesdell,* 321 U. S. 542, 552–553; *Roland Co.* v. *Walling,* 326 U. S. 657, 677; *United States* v. *Henning,* 344 U. S. 66, 77; *United States* v. *Public Utilities Commission,* 345 U. S. 295, 314–315; *United States* v. *Zucca,* 351 U. S. 91, 96. As we shall show, the Veterans Administration regulation requiring veterans to indemnify the

United States for losses sustained on home loan guarantees is not only clearly consistent with the intent of Congress, but in fact is required by the statute. Both the language and the purpose of the Servicemen's Readjustment Act clearly demonstrate that Congress had no intention of making the loan guarantee program a "give-away" plan, by which the Government was to be the loser every time there was a default by the veteran and a depreciation in the value of the house. To the contrary, the statute itself, its legislative history, and its consistent administrative interpretation leave no doubt but that Congress contemplated repayment by the veteran of any losses incurred by the Government in its role as a guarantor.

a. In the first place the act carefully and specifically creates a relationship of "guaranty," using that term over and over again, in almost every section and subsection of the statute. The concept of "guaranty" has a definite and well known legal significance in our law; in every guaranty relationship, "there is an implied promise that the principal debtor will reimburse a guarantor or a surety who has paid the debt to the creditor, and such guarantor or surety has a right of action against the principal for reimbursement". *Joe Balestrieri & Co.* v. *Comm'r.,* 177 F. 2d 867, 872 (C. A. 9). See, *e. g.,* Stearns, *Law of Suretyship* (5th ed.), p. 518; *United States Fidelity & Guaranty Co.* v. *Centropolis Bank,* 17 F. 2d 913 (C. A. 8); *Scott* v. *Norton Hardware Co.,* 54 F. 2d 1047 (C. A. 4); *W. H. Marston Co.* v. *Central Alaska Fisheries Co.,* 210 Cal. 715, 258 P. 933. Congress, of course, is

presumed to use established legal terms with their recognized meaning; *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, 115; *McNally* v. *Hill*, 293 U. S. 131, 136; and when a statute utilizes a transaction familiar to the law, Congress normally means to ascribe to that transaction the same legal consequences that generally flow from it. See, *e. g.*, guaranty—38 Ops. Atty. Gen. 75, 38 *id.* 319; insurance contract—*Ferguson* v. *Union National Bank*, 126 F. 2d 753, 759 (C. A. 4); *Fleetwood Acres* v. *Federal Housing Administration*, 171 F. 2d 440, 442 (C. A. 2); note—*United States* v. *Hansett*, 120 F. 2d 121, 122 (C. A. 2); mortgage—*Home Owners Loan Corporation* v. *Wilkes*, 130 Fla. 492, 178 So. 161.[4]

In the present case, however, it is unnecessary to rely only on the normal meaning of the term "guaranty" to determine defendant's liability for indemnity; for other provisions in the statute itself make it clear that Congress intended the United States to be indemnified for any losses suffered in the course of its home loan guaranty program. Thus, the Act not only limits home loan guarantees to veterans who

[4] A corollary rule of like import also sustains the Government's right to indemnity. This is the settled principle that an established common law remedy is not taken away by a statute except by express enactment or necessary implication. *Shriver* v. *Woodbine Bank*, 285 U. S. 467, 478–9; *United States* v. *Chamberlin*, 219 U. S. 250; *United States* v. *Stevenson*, 215 U. S. 190, 197–199; *King* v. *Pomeroy*, 121 Fed. 287, 290–293 (C. A. 8); and see *Perego* v. *Dodge*, 163 U. S. 160, 167–8. Certainly there is no express waiver of the right to indemnity in the Act; to the contrary, as we shall show, both the statutory language and its consistent administrative interpretation make clear that the Government in fact does have this right.

are "satisfactory credit risks,"[5] but in fact refers to "the resultant indebtedness of the veteran to the Government" in the event the Administrator incurs actual loss or liability on a guaranteed or insured loan 38 U. S. C. 694 (a). Section 506 (a), 38 U. S. C. 694g, dealing with the procedure on default, states that the Administrator "shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid on the guaranty * * *." And Section 506 (b), relating to release from liability, makes clear that a veteran is personally liable to the Administrator for any loan arising out of a home loan guaranty, by providing that on transfer of the mortgaged property the veteran can be relieved of such liability—"including liability for any loss resulting from any default of the transferee * * *"—only if the new purchaser of the property "has obligated himself by contract * * * to assume full liability for the repayment of the balance of the loan * * *." 38 U. S. C. 694g (b).

b. The duty of indemnity which is so plainly implied by the language of the statute is reinforced by the consistent administrative construction of the Act to include a right of the Government to indemnity. In accordance with the general principle of deference to

[5] Section 501 (a) (2) of the Act, 38 U. S. C. 694a (a) (2) states that home loans will be guaranteed only if it is shown, *inter alia*:

"That the contemplated terms of payment required in any mortgage to be given in part payment of the purchase price or construction cost bear a proper relation to the veteran's present and anticipated income and expenses, and the veteran is a satisfactory credit risk * * *."

administrative construction, discussed *supra,* p. 11, the Supreme Court has often recognized the great weight to be given consistent administrative interpretation of veterans legislation by the Veterans Administration. *United States* v. *Citizens Loan & Trust Co.,* 316 U. S. 209, 214; *United States* v. *Madigan,* 300 U. S. 500, 505. This rule, of course, has special applicability where, "* * * it involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new," *Norwegian Nitrogen Products Co.* v. *United States,* 288 U. S. 294, 315, and particularly where, as here, the agency participated in drafting the measure.[6] *United States* v. *American Trucking Associations, Inc.,* 310 U. S. 534, 549.

Moreover, even apart from their importance as a guide to Congressional intent, agency regulations of the type here involved have an independent significance as authoritative statements of the "terms and conditions" upon which Governmental benefits such as insurance or guarantees may be had. As the Supreme Court stated in *Federal Crop Ins. Corp.* v. *Merrill,* 332 U. S. 380, 384:

[6] The Veterans Administration participated actively in drafting all of the provisions of the Servicemen's Readjustment Act of 1944, including the home loan guarantee provisions and amendments thereto. See *e. g.*, Hearings before House Committee on World War Veterans Legislation on H. R. 3917 and S. 1767, 78th Cong., 2d Sess.; Hearings before Senate Committee on Finance on H. R. 3749 and Hearings before House Committee on World War Veterans Legislation on H. R. 3749 and related bills, 79th Cong., 1st Sess.

> Inevitably "the terms and conditions" upon which valid governmental insurance can be had must be defined by the agency acting for the Government. And so Congress has legislated in this instance, as in modern regulatory enactments it so often does, by conferring the rule-making power upon the agency created for carrying out its policy.

In the present case, the Administrator, pursuant to the authority vested in him under 38 U. S. C. 694d, proceeded almost immediately after the enactment of the Servicemen's Readjustment Act of 1944, to define the terms and conditions under which the Government would guarantee veterans' home loans. On October 18, 1944, he promulgated regulations relating to home loan guarantees, and providing, *inter alia,* that "[a]ny amounts paid to the creditor by the Administrator pursuant to the guaranty shall constitute a debt due to the United States by the veteran on whose application the guaranty was made * * *." 38 C. F. R., 1944 Supp., 36.4043. This has consistently remained the position of the Veterans Administration and is incorporated in substantially the same language in the present regulation, 38 C. F. R., 1949 ed., 36.4323 (e), set out *supra,* p. 10.

Moreover, in addition to setting forth his construction of the statute in the regulations, the Administrator as early as 1945 had specifically considered the question of the Government's right to indemnity in the precise circumstances presented here, and published a formal decision on the matter. Decisions of the Administrator of Veterans' Affairs, No. 625 (Jan-

uary 22, 1945), Vol. 1, pp. 1154–1164. In this Decision, the Administrator had to determine whether the Veterans Administration would refuse to guarantee real estate mortgage loans in states such as North Dakota, and California because those states had statutes prohibiting mortgagees from obtaining deficiency judgments. The Administrator considered this question from two aspects: (1) whether under the terms of the Servicemen's Readjustment Act he was authorized to approve an application for guarantee notwithstanding that the mortgagee would be barred from proceeding against the mortgagor for a deficiency judgment in the event of default, and (2) if the Administrator was authorized to guarantee such a loan, what effect would a state deficiency judgment have "on the right of the United States as guarantor to collect from the veteran, by virtue of the right to indemnity that normally exists in favor of a guarantor?" (p. 1154).

The Administrator found first, after a discussion of North Dakota and California law, that while his right as a *subrogee* was restricted by such deficiency judgment provisions, "* * * this does not mean that the United States is not entitled to recover on other legal basis" (p. 1158). Moreover, he pointed out, Congress in legislating for veterans all over the country "intended that so far as possible the benefits of the act should be available irrespective of the particular jurisdiction in which the veteran or the property might be situated" (*ibid.*), and that if it was possible the statute should be construed to accomplish

that result. Accordingly, he held that the Veterans Administration should approve an otherwise suitable loan guaranty application notwithstanding provisions of state law barring deficiency judgments.

Turning to the second aspect of the question, the Administrator noted that although these state law provisions barred the mortgagee from obtaining a deficiency judgment against his mortgagor, they would neither bar the mortgagee from pressing his claim for a deficiency against the United States as guarantor, nor bar the guarantor from then obtaining indemnity from the mortgagor.[7] Moreover, he pointed out, the express contract of indemnity between the veteran and the United States, created by the regulation and the veteran's application for the loan, would be valid under federal law regardless of state law prohibitions. The Administrator therefore concluded that notwithstanding such deficiency judgment statutes, "the United States will be entitled to recover from the veteran indemnification for such amounts as the United States may pay" if the veteran defaults (p. 1164).

These contemporaneous administrative determinations of the Government's right to indemnity, as published in the regulations and in the Administrator's Decision just discussed, are of course presumed to have been known to Congress, *National Lead Company* v. *United States,* 252 U. S. 140. The legislature's failure, despite repeated amendments of the

[7] That the law of California is to this effect, see *infra*, pp. 27–28.

statute,[8] to modify the regulation requires the conclusion that the regulation is consistent with the intent of Congress. *United States* v. *Allen-Bradley Co.*, 352 U. S. 306, 308–311; *Corn Products Co.* v. *Commissioner*, 350 U. S. 46, 53; *Allen* v. *Grand Central Aircraft Co.*, 347 U. S. 535, 544–549; *Shapiro* v. *United States*, 335 U. S. 1, 6; *Commissioner* v. *Flowers*, 326 U. S. 465, 469; *Helvering* v. *Winmill*, 305 U. S. 79; *Norwegian Nitrogen Co.* v. *United States*, 288 U. S. 294, 310–315; *Hecht* v. *Malley*, 265 U. S. 144, 153; see also *Brooks* v. *Dewar*, 313 U. S. 354, 361; *Fleming* v. *Mohawk Co.*, 331 U. S. 111, 118–119; *Mitchell* v. *Covington Mills*, 229 F. 2d 506, 509 (C. A. D. C.), certiorari denied, 350 U. S. 1002.

Nor is Congressional knowledge of the regulation requiring indemnity, and of the consistent administrative practice enforcing this regulation, based only upon a presumption. For these matters were expressly called to the attention of the appropriate committees of both the House and Senate, while Congress was engaged in amending Section 506, the very Section of the statute providing for procedure on default. In the course of considering the legislation which added to that Section the provisions of present subsection (b) (dealing with release from liability), the Chairmen of both the House Committee on Veterans' Affairs and the Senate Committee on Labor and Public Welfare were advised by the Administra-

[8] In the first ten years of its existence, the VA guarantee program was amended at least fourteen times. See 59 Stat. 270; 59 Stat. 542; 59 Stat. 626; 62 Stat. 1209; 62 Stat. 1275; 64 Stat. 74; 65 Stat. 316; 65 Stat. 320; 66 Stat. 64; 66 Stat. 682; 67 Stat. 135; 68 Stat. 320; 68 Stat. 643; 68 Stat. 756.

tor of Veterans' Affairs of the consistent administrative practice, pursuant to regulation, of pressing personal claims for indemnification against all veterans who defaulted on their loans and relinquished property which was not sufficient to satisfy the mortgage debt. H. Rept. 1971, 84th Cong., 2d Sess., pp. 4, 7; S. Rep. 2489, 84th Cong., 2d Sess., pp. 4, 9. Moreover, the Senate Report expressly recognizes (p. 4) that "[i]f the second purchaser defaults and there is a deficiency claim as a result thereof, the original veteran purchaser is liable for such deficiency under the present laws." And, as we have shown above (*supra,* p. 14), this new provision was expressly intended to create a method of relieving the veteran of this liability if he sold the house.[9]

c. We believe that the foregoing discussion clearly demonstrates that the United States is entitled to be indemnified by veterans for losses sustained under the loan guarantee program. Defendant, however, relies heavily upon the fact that Section 506 (a) specifically mentions only the Government's right to subrogation, and argues that the United States is therefore confined to this remedy in the event of default. But subrogation is only one of the "three great equitable rights" of a guarantor, Stearns, *The Law of Suretyship* (5th ed.) §§ 11.1, 11.18, 11.35; the

[9] As noted above, *supra*, p. 14, the language of this subsection refers expressly to the veteran's "liability for any loss resulting from any default," and otherwise clearly demonstrates that its purpose is to permit a veteran who sells a mortgaged house to be relieved of his *personal* liability for the mortgage debt only if he arranges for his transferee to assume this debt.

others being indemnity and contribution. These remedies are cumulative, not exclusive and all normally flow from the guaranty relationship. As we have pointed out (*supra,* pp. 12–13), Congress, in expressly creating such a relationship, must be presumed to have included all of the rights and obligations which normally attach thereto. Indeed, we have shown that both the statutory language and the consistent administrative construction of the Act conclusively demonstrate the Congressional intent to impose a personal liability for reimbursement. Accordingly, there plainly was no impropriety in the Administrator's spelling out his right to indemnity in addition to that of subrogation.

Moreover, the legislative history of this language makes perfectly clear that the use of the word subrogation in Section 506 (b) is in reference only to the Government's right to *security,* and in no way limits its right to *reimbursement.* Section 500 (b) of the 1944 Act, 58 Stat. 291, originally provided that "* * * No security for the guaranty of a loan shall be required except the right to be subrogated to the lien rights of the holder of the obligation which is guaranteed * * *". When the statute was revised in 1946, this language was abbreviated and moved into the new Section 506, entitled "Procedure on Default," 59 Stat. 626 *et seq.* There is no evidence whatever that this change was intended to limit the Government's right to reimbursement, whether by subrogation or indemnity; to the contrary, the outstanding regulation and

the Administrator's Decision, discussed *supra,* pp. 16–18, require the opposite conclusion.[10]

And, finally, whatever doubt may still have existed of the Government's right to indemnity was conclusively dispelled in 1956 by the addition to Section 506 of subsection (b), providing for release from liability, 70 Stat. 913. As we have already shown, this subsection was enacted into law after specific advice to both Houses of Congress from the Administrator of Veteran's Affairs of the Agency's consistent practice of requiring indemnity from defaulting veterans. Although Congress was amending the very Section of the Act upon which appellant relies, it took no action whatever to change the statute so as to nullify or alter the administrative practice. Instead, as we have shown, the language of Section 506 (b) expressly takes this obligation into account by referring to the borrower's "liability for any loss" and "full liability for the repayment of the balance of the loan." In these circumstances, it is perfectly clear that the Veterans Administration regulation requiring a veteran to indemnify it for the losses which it suffered in guaranteeing his home loan is valid.[11]

[10] Thus, as the Administrator stated in 1945 in Decision No. 625, *supra*, at p. 1159, the provision regarding subrogation deals "with the question of what property rights are acquired by the veteran, not what liability he assumes personally. From the Government's *security* standpoint the statute deals with the question of what liens on the property the Government acquires * * *. The Government's chief *protection* consists of its rights to be 'subrogated to the lien rights.'" (Emphasis added.)

[11] The foregoing discussion clearly demonstrates the distinction between the situation here and that involved in *United States*

2. *The regulation is binding upon defendant.* As we have just shown (*supra,* pp. 11–22), defendant's obligation to indemnify the United States for the loss incurred in guaranteeing his home loan is fixed by a valid regulation. This regulation was published in the Federal Register (11 F. R. 2123, March 1, 1946) and was "binding on all who sought to come within the [guarantee program]." *Federal Crop Ins. Co.* v. *Merrill,* 332 U. S. 380, 385; see also *United States* v.

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v. *Plesha*, 352 U. S. 202. The *Plesha* case involved the provision of Article IV of the Soldiers' and Sailors' Civil Relief Act of 1940 under which men inducted into the Armed Forces would continue to receive the protection of previously purchased commercial life insurance while in the service without paying premiums. The Government had assured the insurance companies that the premiums on the polices would be paid by giving its promissory certificates to the companies. The question presented in *Plesha* was whether in so doing, the United States had created the relationship of guarantor between itself and the servicemen, so that in the event that the latter failed to pay back premiums on their commercial insurance after they were discharged from the service, the United States would be entitled to reimbursement from these servicemen for any losses which it suffered on its promissory certificates. The Supreme Court held that "the language of the 1940 Act, its legislative history and its administrative interpretation" demonstrated that the veterans were not so liable. As we have shown, however, all three of these considerations—the language, legislative history, and administrative interpretation of the Servicemen's Readjustment Act—in the present case clearly establish the liability of a veteran to indemnify the United States for a loss sustained in guaranteeing a home loan.

Thus, the fundamental issue in *Plesha* was whether the statute in fact created a guaranty relationship, and reasoning that it did not, the Court denied the Government's right to indemnity (352 U. S. at 211). Here, however, the statute *expressly* creates a guaranty relationship, and the only issue is whether in providing for such a relationship, Congress intended it to include its normal common law implications. As

Zazove, 334 U. S. 602. As the Supreme Court stated in the *Merrill* case, 332 U. S. at 384–5, "[j]ust as everyone is charged with knowledge of the United States Statutes at Large, Congress has provided that the appearance of rules and regulations in the Federal Register gives legal notice of their contents."

Moreover, the regulation requiring indemnity was

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we have shown above, Congress clearly so intended. Further, in striking contrast to the situation here, the legislative history in *Plesha* demonstrated that initially Congress expected to sustain losses as a result of its program (352 U. S. at 206–207); and the Court found that in subsequently amending the statute to require reimbursement, "Congress thought it was changing the law by changing the language of the Act" (352 U. S. 208). Here, on the other hand, not only did Congress from the very first clearly indicate its intention that the United States be repaid for any losses suffered under the loan guarantee program, but, with specific knowledge of the regulation requiring indemnity proceeded to amend the very Section here involved without making any pertinent change in such liability. Finally, and equally important, is the fact that, unlike the situation in *Plesha*, the consistent interpretation of the Act by the Agency administering it fully supports the Government's right to indemnity. In *Plesha*, the administrative agency generally ignored, and at times even *expressly disclaimed*, the liability of the serviceman to reimburse the United States. See 352 U. S. 208–210. In the instant case, however, the Veterans Administration, both by regulation and by a formal Decision of the Administrator, immediately took the position that the Government was entitled to indemnity. This position was incorporated by reference in the contracts signed by the veterans in obtaining loan guarantees and was enforced throughout the administration of the home loan program.

In short, the statute here involves an entirely different type of statutory benefit from that in *Plesha,* phrased in entirely different terms; and, unlike the situation in *Plesha*, here both the Congress and the Agency administering the benefit have clearly provided for and recognized the liability of the veteran to reimburse the United States for its losses.

incorporated by reference into the Home Loan Report itself, which was the formal application and document signed by the veteran in order to obtain the loan guarantee. The Report expressly provided that "[r]egulations issued under the Act, and in effect on the date of any loan which is submitted or approved for guarantee or insurance thereunder shall govern the rights, duties, and liabilities of the parties as to such loan * * *." The present regulation requiring indemnity was published in 1946, and was in full force and effect in August, 1947, when defendant signed the application for his loan guarantee. Accordingly, it clearly was a binding condition of the guarantee. *Federal Crop Ins. Co.* v. *Merrill, supra,* 322 U. S. at 385.

In light of the persuasiveness of the foregoing considerations, it is not surprising that every court which has considered the problem has ruled that the United States is entitled to full indemnity under the Act and regulation. Thus, the three federal courts which have published decisions upon this question, as well as the court below, have unanimously agreed that the regulation places a veteran under an independent and enforceable obligation to indemnify the United States for any losses incurred as the result of a loan guarantee under the statute. *United States* v. *Gallardo,* 154 F. Supp. 373 (N. D. Calif.); *United States* v. *Jones,* 155 F. Supp. 52 (M. D. Ga.); *United States* v. *Henderson,* 121 F. Supp. 343 (S. D. Iowa). As stated in the *Henderson* decision (121 F. Supp. at 344):

> The language of this provision [38 C. F. R. 36.323 (e), *supra*] is clear and there can be no question therefrom of the intent of the Cong-

> ress to make any payments made by the Government under the guarantee of the Act an enforceable demand until full satisfaction is obtained. * * * Defendant's liability, created when his loan application was made out and the note and mortgage executed, remains a direct and subsisting obligation until the Government has been repaid.

We submit that the court below properly held that defendant, too, is under a valid and subsisting obligation to indemnify the United States for the loss which it sustained by reason of his default on a guaranteed home loan.

B. The Government's right to indemnity from the defendant is in no way impaired by provisions of California law barring deficiency judgments

As we have shown (Point IA, *supra,* pp. 10–26), defendant has an express duty to indemnify the United States for losses which it suffered in guaranteeing his home loan. Defendant, however, attempts to avoid his clear liability by arguing that the Government's right to recover is barred under Section 580 (b) of the California Code of Civil Procedure prohibiting deficiency judgments arising from sales of real property. We submit that this contention is totally without merit. In the first place, the Government's suit is not for a deficiency judgment, but for recovery under an independent contract of indemnity; and secondly, since the Government's claim is based directly upon a Federal statute and regulation, its right of recovery cannot in any event be impaired by operation of state law.

1. *The Government is suing upon an independent contract of indemnity, and not for a deficiency judg-*

ment. Section 580 (b) of the California Code of Civil Procedure, in forbidding deficiency judgments on the foreclosure of real estate mortgages, has no application to a suit against the mortgagor on an independent contract of indemnity. As we have shown in Point IA (*supra,* pp. 10–26), the Government's right to be indemnified by defendant arises from an express statutory and contractual obligation on the part of the latter to indemnify the Government for its loss. Such an action for indemnity, unlike a suit to enforce a right of subrogation, is in no way impaired by personal defenses which the defendant might have to a suit by his creditor. Stearns, *The Law of Suretyship* (5th ed.), p. 523; Simpson, *Suretyship,* p. 227.[12] Accordingly, the Government's right to recovery here is not affected by statutory restrictions on deficiency judgments, which the California courts have expressly held to apply only to claims by the creditor himself against the principal on the original obligation, and have "no application to an action based upon the independent obligation of a guarantor." *Bank of America Nat. Trust & Savings Assn.* v. *Hunter,* 8 Cal. 2d 592, 67 P. 2d 99. See also *Everts* v. *Matteson,*

[12] The surety's right of *subrogation*, where he obtains all of the rights of the creditor but is subject to all of the defenses which the principal might have against the creditor, is, of course, to be carefully distinguished from his right of *indemnity*, which arises out of an independent contract between the principal and surety, and thus does not depend on the rights *inter se* between the principal and creditor. See, *e. g.*, the discussion in Stearns, *supra*, §§ 11.1, 11.18, 11.35 distinguishing between the rights of subrogation, contribution and indemnity.

132 P. 2d 476; *Security-First Nat. Bank of Los Angeles* v. *Chapman,* 41 Cal. App. 219, 106 P. 2d 431, 432.

Nor is the Government's right to full reimbursement impaired by the fact that it paid a debt for which the defendant may not have been liable. It is well settled that a guarantor retains his right to reimbursement even though he pays a debt upon which the principal himself would not have been liable to the creditor, so long as the non-liability of the principal arises from causes which do not afford a defense to the guarantor. Stearns, *supra,* p. 523; Simpson, *supra,* § 48. In the instant case, it is plain that, although the bank might have been barred from obtaining a deficiency judgment against the defendant, it was in no way prohibited from holding the Government to its guarantee to pay this money. The California courts have made clear that the statutory provisions restricting deficiency judgments refer only to money judgments obtained by the creditor directly against the principal and do not foreclose the creditor from proceeding against any other security which he may hold from his principal, including an independent contract by a third party guaranteeing the debt. *Hatch* v. *Security-First Nat. Bank,* 19 Cal. 2d 254, 120 P. 2d 869; *Mortgage Guarantee Co.* v. *Sampsell,* 51 Cal. App. 2d 180, 124 P. 2d 353; *Security-First Nat. Bank of Los Angeles* v. *Chapman,* 41 Cal. App. 219, 106 P. 2d 431; *Bank of America Nat. Trust & Savings Assn.* v. *Hunter,* 8 Cal. 2d 542, 67 P. 2d 99; cf. *Loeb* v. *Christie,* 6 Cal. 2d 416, 420, 57 P. 2d 1303. Accordingly, since the Administrator was required as guarantor to pay the balance due on defendant's in-

debtedness, he is entitled to full reimbursement from the defendant.

The three Federal court decisions cited above, *supra,* p. 25, have expressly recognized the independent and subsisting liability of veterans to indemnify the United States for any losses incurred in guaranteeing home loans, regardless of the exhaustion of the original security or of state laws preventing deficiency judgments. In *United States* v. *Henderson,* 121 F. Supp. 343 (S. D. Iowa), the defendant argued that the Government's claim for indemnity could not be sustained because the original obligation had been retired by virtue of a state court judgment obtained by the creditor, and, under Iowa law, could no longer be enforced against him. The district court held, however, that under the regulation requiring indemnity (38 C. F. R. 36.4323), any payments made by the Government under its guaranty constituted "an enforceable demand until full satisfaction is obtained," 121 F. Supp. at 344. The court continued (*ibid.*): "Foreclosure proceedings could only extinguish the debt (as the entire loan could be a potential debt under the regulation), for that amount credited on the loan as a result of such action." This language was expressly adopted in *United States* v. *Jones,* 155 F. Supp. 52 (M. D. Ga.), where the court likewise recognized the right of the United States to recover under its contract of indemnity notwithstanding provisions of Georgia law barring deficiency judgments. And in *United States* v. *Gallardo,* 154 F. Supp. 373 (N. D. Cal.), District Judge Murphy

also "heartily endorse[d]" the reasoning of the *Henderson* decision in holding that "the principal creditor's settlement of the State court action did not extinguish defendant's debt to the United States which was created when the United States made payment to the principal creditor pursuant to its guarantee," 154 F. Supp. at 374. This language is squarely applicable here and, we submit, conclusively demonstrates that the right to indemnity is not affected by the state deficiency judgment statute.

2. *In any event, the Administrator's right to indemnity arises under federal law, and cannot be impaired by a state statute.* We have just shown (*supra,* pp. 26–30) that there is no conflict between the right of the Administrator to indemnity from the defendant and the California statute barring deficiency judgments. But even if the state law is interpreted to apply to indemnity contracts, it plainly cannot bar recovery here by the Administrator. As we have shown (*supra,* pp. 10–26), the Government's claim is predicated upon an independent right of indemnity, which by valid regulation constitutes one of the terms and conditions under which the federal government insured defendant's loan. Since this unconditional right of indemnity exists as part of a contract with the federal government, it is governed solely by federal law; "[t]he validity and construction of [Government contracts] present questions of federal law." *Pack* v. *United States,* 176 F. 2d 770, 771, (C. A. 9). See, *e. g., Wissner* v. *Wissner,* 338 U. S. 655; *Clearfield Trust Co.* v. *United States,* 318

U. S. 363; *Royal Indemnity Co.* v. *United States*, 313 U. S. 289.[13]

The *Wissner* decision is, we submit, squarely in point. The Supreme Court there held that the proceeds of a National Service Life Insurance policy were to be distributed according to the terms of the policy itself without regard to the conflicting provision of California community property laws. To interpret the policy in terms of state law, said the Court, would frustrate "the deliberate purpose of Congress," 338 U. S. at 659.

Here, too, the Government's right of indemnity, as a valid part of the statutory and regulatory scheme governing the rights and duties of the parties under a contract to guarantee a federal home loan can in no way be diminished or destroyed by provisions of state law. In the event of a conflict between the regulation providing for indemnity and provisions of California law restricting that right, the Supremacy

[13] There is no need to dwell on the proposition that powers of the federal government are supreme over any conflicting state laws. Article 6, Clause 2, of the Constitution. See *e. g.*, *Testa* v. *Katt*, 330 U. S. 386; *Ex Parte Siebold*, 100 U. S. 371, 392; *Claflin* v. *Houseman*, 93 U. S. 130. The manifest purpose of the Supremacy Clause is to remove all state obstacles to the performance by the federal government of any of its functions and so modifies "every power vested in subordinate governments, as to exempt its own operations from their influence." *McCulloch* v. *Maryland*, 4 Wheat. 316, 427. This freedom from conflicting state regulation is, of course, coextensive with the scope of federal power, since every authorized activity of the United States is an exercise of its governmental power. *Graves* v. *N. Y. ex rel. O'Keefe*, 306 U. S. 466, 477; *Pittman* v. *Home Owners' Corp.*, 308 U. S. 21, 32; *Federal Land Bank* v. *Bismarck Lumber Co.*, 314 U. S. 95, 102.

Clause of the Constitution and the cases cited above make clear that the federal regulations must govern.

II. The District Court properly computed the amount of the loss suffered by the United States

Appellant contends (Br., pp. 5–7) that in computing the amount of the loss suffered by the United States the court below erred in refusing to admit evidence relating to the acquisition and subsequent resale of the house by the VA. Defendant contends that in the course of these transactions, which took place after the trustee's sale and after payment of the guarantee by the Administrator, the VA substantially reduced its loss, and that its recovery from the defendant should be diminished accordingly. We submit that under settled principles of mortgage and indemnity law, the Government's loss for purposes of indemnity was fixed at the time of the trustee's sale, and the subsequent events to which defendant refers could operate neither to increase nor decrease the extent of his obligation to indemnify his guarantor.

1. *The transactions involved.* As we have shown in the Statement of the Case, *supra,* pp. 3–4, the lender bid at the trustee's sale the sum of $5,500.00, which the VA had established to be the "upset" price of the house. This amount was credited to defendant's debt; in addition, the VA had paid the lender the full amount of its guarantee, $3,375.00. Thus, at the moment after the trustee's sale, the lender has in its possession a house, the value of which has been fixed at $5,500.00, plus $3,375.00 which the VA had paid on its guarantee. Since the lender was entitled only to

$6,953.64 to make itself whole, the balance of $1,921.36 ($8,875.00 less $6,953.64) was credited to the VA against the $3,375.00 it had paid. This left the VA with an "out-of-pocket" loss as fixed at the time of the trustee's sale, of $1,453.64 ($3,375.00 less $1,921.36), and it was this amount which the court below awarded to the United States, together with interest and costs.

Defendant argues, however, that in computing the Government's loss, the following additional facts must be considered: The lender, instead of exercising its option of retaining the house and remitting to VA the unused portion of the $3,375.00, chose to tender the house itself to VA, which the VA was obliged to accept at the established upset price of $5,500 (38 C. F. R. 36.4320 (b)). Since the lender already had in its possession the $1,921.36 which was to be credited to VA as the balance of its payment of $3,375.00, VA then made payment to the holder of the balance of the $5,500.00 (together with certain further incidental costs). Defendant, pointing out that the VA thus acquired the house for a total cost of $7,047.50, wished to prove further that VA sold the house for a net price of $6,631.88, thereby suffering a loss on the whole transaction of only $415.62, instead of $1,453.64 as found by the district court. The district court rejected defendant's offer to prove these additional facts, as not material to a determination of his liability of indemnity. As we shall show, the extent of defendant's liability both to the mortgagee and to the guarantor was fixed as a matter of law at the time of the trustee's sale, and accordingly,

the district court properly excluded this evidence of subsequent events.

2. *The applicable law.* It is a settled principle of mortgage law that the value of the mortgagor's equity in the mortgaged property is fixed by the amount bid at the foreclosure sale, and accordingly that, in the absence of fraud, a mortgagor has no right to compel a mortgagee to account to him for any profit made upon a subsequent resale of the premises. *General Auto Truck Co.* v. *Rust,* 88 F. 2d 774 (C. A. D. C.); *Ramsden* v. *Keene Five Cents Savings Bank,* 198 Fed. 807 (C. A. 8), certiorari denied, 196 U. S. 638; *Mangano* v. *Guaranty Building & Loan Assoc.,* 4 Cal. App. 2d 608, 42 P. 2d 329; *Pennsylvania Ave. Fed. Sav. & Loan Assoc.* v. *Fedder,* 175 Md. 127, 199 A. 785; *Gehlert* v. *Smiley,* 114 S. W. 2d 1029 (Mo.); *Woodlee* v. *Burch,* 43 Mo. 231; *South Amboy Trust Co.* v. *McMichael Holdings,* 141 N. J. Eq. 12, 56 A. 2d 437. "The deficiency on a mortgage is determined by the foreclosure sale and is not reduced by an advantageous resale." *Berman* v. *One Forty-Five Belmont Ave. Corp.,* 109 N. J. Eq. 256, 156 A. 830.

The liability of the guarantor of the mortgage is likewise fixed by the foreclosure sale, and he too has no right to a reduction of his liability to the mortgagee for a deficiency on foreclosure if the mortgagee makes a profit on reselling the property, 24 Am. Jur. Guaranty § 123, p. 955. And by the same token, the liability of the mortgagor to his guarantor for any deficiency obviously is also fixed by the amount received at the foreclosure sale; contrary to defendant's contention, it is perfectly clear that where a guarantor

subsequently acquires the mortgage property, he has no obligation to account to the mortgagor for any profit made in reselling it. *Pennsylvania Ave. Federal Savings & Loan Assoc.* v. *Fedder, supra; United States* v. *Jones,* 155 F. Supp. 52 (M. D. Ga.).

In the *Jones* case, the court disposed of precisely such a contention with the following language (155 F. Supp. at 56):

> But as I see it, whether or not the Veterans Administration has made a profit as a result of its purchase of this property from the Reconstruction Finance Corporation, or whether it should make such profit in the future is immaterial to the present inquiry. The plaintiff's loss on its guaranty agreement was determined when the foreclosure sale occurred and resulted in a deficit of $865.23 and when the payee of the note demanded and received payment from the Veterans Administration of said sum. If the Veterans Administration should incur an additional loss by reason of its purchase of the property from the purchaser at the foreclosure sale it could hardly be said that as guarantor it could recover from the defendant such additional loss in addition to the $865.23 sued for. Likewise, it would not be responsible to the defendant for any profit on such subsequent and independent transaction. See in this connection, 38 C. J. S. Guaranty § 111, page 1298; 24 Am. Jur., page 875, Guaranty, Section 4, page 955, Guaranty, Section 123; 59 C. J. S. Mortgages §§ 518, 599, pages 848, 1044; 37 Am. Jur., page 188, Mortgages, Section 783.

We submit that this reasoning, impelled by fundamental considerations of the law of mortgage and of

suretyship, is squarely applicable here, and clearly demonstrates the error of defendant's contention.

CONCLUSION

For the foregoing reasons we respectfully submit that the judgment below should be affirmed.

GEORGE COCHRAN DOUB,
Assistant Attorney General,
LAUGHLIN E. WATERS,
United States Attorney,
MORTON HOLLANDER,
ROBERT S. GREEN,
Attorneys,
Department of Justice, Washington 25, D. C.

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